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Post-War Refund of Excess-Profits Tax

THIS BULLETIN deals with the reporting, in financial statements, of the post-war refund of excess-profits tax provided for in section 250 of the Revenue Act of 1942.

SUMMARY STATEMENT

(1) In the balance sheet the amount of excess-profits tax payable (without deduction for the so-called post-war credit provided by section 780 (a), as limited by section 783 (c) of the Internal Revenue Code, which sections were added by section 250 of the Revenue Act of 1942) should be shown as an accrued liability in the current liability section; the amount of such post-war credit, representing the right to receive government bonds or the par value of government bonds received therefor, should be shown, at least as long as they remain non-negotiable, as a non-current asset.

(2) In the income statement, effect should be given to the full amount of excess-profits tax, the amount of the post-war credit under section 780 (a), and the amount of the debt-retirement credit under section 783, if any, with appropriate disclosure as to each such amount.

(3) If it is desired to utilize the amount of the post-war credit as, in effect, a reserve for post-war contingencies, this result should be accomplished by separate action under rules relative to such reserves set forth in Accounting Research Bulletin No. 13.

DISCUSSION

Under section 250 of the Revenue Act of 1942 (adding sections 780–783 to the Internal Revenue Code) the Secretary of the Treasury is authorized and directed to establish a credit (hereinafter referred to as the post-war credit) to the account of each taxpayer for each taxable year ending after December 31, 1941 (except in the case of a taxable year beginning in 1941 and ending before July 1, 1942), and not beginning after the cessation of hostilities, in an amount equal to 10 per cent (subject to limitation in 1942 in the case of certain fiscal year companies) of the taxpayer's excess-profits tax. This credit is to be applied to the purchase of bonds issued under authority of the Second Liberty Bond Act.

The bonds bear no interest; they are not negotiable or transferable by sale, exchange, assignment, pledge, hypothecation or otherwise before the end of the war. After the date of cessation of the war the bonds will be negotiable and transferable and will be redeemable at the option of the United States. The bonds mature in from two to five years after the termination of the war, depending upon the taxable year in which they were acquired.

Under section 783, the taxpayer may currently take a credit (hereinafter referred to as the debt-retirement credit), subject to certain limitations as to amount, against current excess-profits taxes for indebtedness retired during the taxable year, and to the extent that such debt-retirement credit is taken, the post-war credit is correspondingly reduced.

In its report on the Revenue Bill of 1942 the Senate Finance Committee indicated that these provisions were deemed desirable "in order to encourage efficient and economical corporate management under the stress of war economy and to provide a fund that will be available for the conversion of production facilities after the war to peacetime demands," thus implying that the 10 per cent credit constitutes a partial return of excess-profits tax to the corporation. The credit is referred to as a "refund" of excess-profits taxes to be made after the war. The Finance Committee further explains that the debt-retirement credit makes it possible for taxpayers with heavy tax commitments to "use their post-war credit currently rather than wait until the termination of the war to meet such commitments."

The basic question is whether the post-war credit should be currently recognized in the income statement as reducing the amount of excess-profits tax properly chargeable in the current period or whether recognition should be deferred to the accounting period in which the bonds become negotiable or in which they mature.

In support of the latter alternative it may be urged that the full amount of the excess-profits tax must be paid now; that no funds will be or can in any way be made available until the post-war period; and that the time when the bonds will become negotiable or mature is uncertain and the amount of credit should not, therefore, be treated as an asset in its full amount if at all.

It is recognized that the last-mentioned argument has some theoretical validity. However, the same argument might be applied to other assets which it is not customary to discount; and since the discount in this case would be relatively small, the committee does not believe that a meticulous insistence on this point is desirable. The committee does not believe that the uncertainties of the post-war period warrant deferment. These uncertainties should as far as possible be taken care of under the rules of Accounting Research Bulletin No. 13. Clearly, the needed reserves will vary in different cases.

While the full amount of the excess-profits tax is presently payable and therefore must be shown as a current liability, the post-war credit is currently determinable and unconditional as to its ultimate use. The argument for reflecting it currently in the income account is strengthened by the fact that taxpayers are given the credit currently for debt retirement.

Balance-sheet Presentation

The amount of excess-profits tax presently payable should be shown as a current liability in the balance sheet since it is an obligation requiring cash payments within a short period of time. In arriving at that amount the debt-retirement credit may be deducted from the gross amount of the tax but no deduction is permissible for the post-war credit. The amount of the latter, representing government bonds at par, or the right to receive such bonds, should manifestly be shown as a non-current asset at least so long as the bonds remain non-negotiable.

Income-statement Presentation

Effect should be given in the income statement to the gross amount of the excess-profits tax, the debt-retirement credit, if any, and the post-war credit, with adequate disclosure as to the amount of each, in order that such statement may be reasonably informative. No single rule can be established as to what constitutes adequate disclosure under the circumstances of various cases. Ordinarily a showing of the gross amount of the tax with a deduction for credits will be satisfactory; if the net amount of tax payable is shown in the statement, disclosure may take the form of a footnote. Where the post-war credit is substantial in relation to what net income would be if no such credit were allowable, it may be useful to show income after taxes but before the credit and to add the credit before arriving at the final balance transferred to earned surplus. The precise method of disclosure is left to the exercise of judgment by the corporation and the independent auditor on the basis of the surrounding circumstances.

The statement entitled "Post-War Refund of Excess-Profits Tax" was adopted by the assenting votes of twenty members of the committee. One member, Mr. Towns, dissented.

Mr. Towns dissents on the ground that it would be more appropriate to have the credit made to deferred income than to the income account or to surplus, since the asset cannot be sold, used in the business, or used as collateral for two years or more.

NOTES

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)